Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: 200644016

Release Date: 11/3/2006

CC:PSI:B02:BRPoston
POSTN-120171-05

Third Party Communication: None
Date of Communication: Not Applicable

UILC: 691.01-00, 661.00-00

date: July 13, 2005

to: Special Counsel to SB Division Counsel
(Small Business/Self-Employed)

from: Chief, Branch 2
(Passthroughs & Special Industries)

---

subject:

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent under § 6110(j)(3) of the Code.

ISSUE

Are items of ordinary income in respect of a decedent (IRD) within the meaning of § 691 received by an estate and which are properly included in the estate's gross income included in the estate's distributable net income (DNI) under § 643(a) and used to determine the estate's income distribution deduction under § 661?

CONCLUSION

In general, ordinary IRD items received by an estate which are properly included in the estate's gross income are included in DNI and used to determine the income distribution deduction.

FACTS

The facts submitted to our office indicate that a number of estates and trusts are under examination with a similar set of relevant facts. Because we have been informed that most of the pending cases involve estates, we will refer only to estates in this memorandum, but the same analysis applies to trusts. The estate has received an item of ordinary IRD which is properly included in its gross income (although allocated to corpus under applicable state law) and makes a distribution of cash to beneficiaries in the same taxable year (or, if the relevant election has been made, within the sixty-five day period described in § 663(b)). Common examples of such ordinary IRD items would include amounts received from individual retirement accounts (IRAs) and qualified or non-qualified deferred compensation plans. The estate completes its Form 1041, U.S. Income Tax Return for Estates & Trusts, including the IRD received in its DNI and claiming an income distribution deduction based on that inclusion.

LAW AND ANALYSIS

Section 643(a) generally defines the term "DNI" as the taxable income of the estate computed with certain modifications.

Section 661(a) provides that in any taxable year a deduction is allowed in computing the taxable income of an estate, for the sum of (1) the amount of income for such taxable year required to be distributed currently; and (2) any other amounts properly paid or credited or required to be distributed for such taxable year, but such deduction shall not exceed the DNI of the estate.

Section 691(a)(1) provides that the amount of all items of gross IRD which are not properly includible in respect of the taxable period in which falls the date of the decedent's death or a prior period (including the amount of all items of gross income in respect of a prior decedent, if the right to receive such amount was acquired by reason of the death of the prior decedent or by bequest, devise, or inheritance from the prior decedent) shall be included in the gross income, for the taxable year when received, of: (A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent; (B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or (C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

Section 691(a) causes items of IRD received by an estate to enter into its gross income, and thus its taxable income, unless removed by some other provision. DNI under § 643(a) is defined as taxable income with certain modifications, none of which are relevant under the facts described above. Therefore, under the circumstances described above, DNI will generally include the IRD items received if those items were properly included in the gross income of the trust. The income distribution deduction of the estate under § 661(a) will be limited by the DNI so calculated. The beneficiary who receives a distribution from the estate will include the IRD received in that beneficiary's gross income subject to the rules of § 662.

Rollert v. Commissioner, 752 F.2d 1128 (6th Cir. 1985), which has been cited for the general proposition that IRD items are not included in DNI, concerns a factually and legally distinguishable situation. In Rollert, an estate claimed an income distribution deduction for the distribution of rights to receive future payments of IRD to the decedent's residuary trust, without having taken the value of the rights into the estate's gross income. The Court correctly held that this treatment was inconsistent with § 691 and that the full value of the payments actually received was includible as IRD in the years received by the residuary trust. The assignment of rights to receive IRD to a beneficiary by a trust or estate is governed by different rules than the receipt of actual payments by the trust or estate, followed by a distribution of cash to the beneficiaries. There is no conflict between Rollert and our conclusion in this memorandum. We would note that, in Rollert, the estate would not have been eligible to take the § 661 deduction even if it had taken the present value of the rights into its gross income, because the estate was not the proper party to include any amounts in gross income, as § 691 requires inclusion in gross income of only the actual payments and only by the party receiving those payments.

We would recommend that the cases currently in examination should be resolved consistent with this memorandum, and that training and audit materials should reflect this position. Cases where a deduction has been claimed for the distribution of future rights to IRD (as in Rollert), cases involving distributions made in a subsequent taxable year (or beyond the § 663(b) period, if an election has been made under that section), or cases involving items of capital gain IRD may require further coordination with the Office of Chief Counsel.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call if you have any further questions.